Supreme Court, U. S.
FILED
FEB 4 1978
MICHAEL RODAK, JR., CLERK

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-1098

HARVEY L. BELL
SECURITIES COMMISSIONER
FOR THE STATE OF ARKANSAS ..... *Petitioner*

vs.

INTERNATIONAL TRADING, LTD.,
A DIVISION OF GNB, INC.,
J. R. ROSE AND ARTHUR PALMER ..... *Respondents*

## PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF ARKANSAS

HARVEY L. BELL
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REQ. No. 77-11226 55 COPIES

# Table of Contents


Page

List of Authorities ..... ii

Opinion Below ..... 2

Jurisdiction ..... 2

Question Presented ..... 2

Statutory Provisions Involved ..... 2

Statement of the Case ..... 5

Reason for Granting Writ ..... 7

Conclusion ..... 16

APPENDICES

A. Opinion of Arkansas Supreme Court ..... 17

B. Order Entered by Chancellor,
Pulaski County, Arkansas, Chancery Court ..... 31

C. Order of Arkansas Supreme Court Denying Rehearing ..... 34

# List of Authorities

Page

## STATUTES


7 U.S.C. § 2 ..... 2

Ark. Stat. Ann. § 67-1247(1) (Repl. 1966) ..... 3

Ark. Stat. Ann. § 67-1247(L) (Repl. 1966) ..... 5

Ark. Stat. Ann. § 67-1235 (Repl. 1966) ..... 3

Ark. Stat. Ann. § 67-1254 (Repl. 1966) ..... 4

Ark. Stat. Ann. § 67-1255 (Supp. 1977) ..... 14

Ark. Stat. Ann. § 41-2203 (Crim. Code 1976) ..... 14


## JUDICIAL DECISIONS


*Berman* v. *Orimex Trading, Inc.*,
291 F. Supp. 701 (S.D.N.Y. 1968) ..... 8

*Clayton Brokerage Co.* v. *Mouer*,
520 S.W. 2d 802 (Tex. Civ. App. 1975),
*rev'd on other grounds*, 531 S.W. 2d
805 (Tex. Sup. Ct. 1975) ..... 11

*Commercial Iron & Metal Company* v.
*Bache & Company, et al.*,
478 F. 2d 39 (10th Cir. 1973) ..... 9

*Gould* v. *Barnes Brokerage Company, Inc.*,
345 F. Supp. 294 (N.D. Tex. 1972) ..... 8

*Hamilton* v. *Kentucky Distilleries and*
*Warehouse Company*, 251 U.S. 145 (1919) ..... 12

*Hirk* v. *Agri-Research Council, Inc., et al.*,
CCH Sec. L. Rep. par. 94, 738 (N.D. Ill. 1974) ..... 9

*International Trading, Ltd., et al.* v. *Bell*,
262 Ark. 244, 556 S.W. 2d 420 (1977) ..... 8

*J. C. Booth* v. *Peavey Company Commodities*
*Services*, 430 F. 2d 132 (8th Cir. 1970) ..... 8





*Johnson* v. *Espey, et al.*,
341 F. Supp. 764 (S.D.N.Y. 1972) ..... 8

*Mahue* v. *Reynolds & Company*,
282 F. Supp. 423 (S.D.N.Y. 1967) ..... 8

*Marshall* v. *Lamson Brothers & Company, et al.*,
368 F. Supp. 486 (S.D. Ia. 1974) ..... 8

*McCurrin* v. *Kohlweger & Company, et al.*,
340 F. Supp. 1338 (E.D. La. 1972),
*aff'd*, 477 F. 2d 113 (5th Cir. 1973) ..... 8

*Milnarik* v. *M. S. Commodities, Inc.*,
320 F. Supp. 1149 (N.D. Ill. 1970),
*aff'd* 457 F. 2d 274 (7th Cir. 1972),
cert. denied 409 U.S. 887 (1972) ..... 9

*Northern States Power Company* v. *Minnesota*,
447 F. 2d 1143 (8th Cir. 1971) ..... 13

*Schwartz* v. *Bache & Company, Inc.*,
340 F. Supp. 995 (S.D. Ia. 1972) ..... 9

*Securities and Exchange Commission* v.
*Continental Commodities Corp.*,
497 F. 2d 516 (5th Cir. 1974) ..... 8

*Sinva, Inc.* v. *Merrill Lynch, Pierce,*
*Fenner & Smith, Inc.*,
253 F. Supp. 359 (S.D.N.Y. 1966) ..... 8

*Wasnoivic* v. *Chicago Board of Trade*,
352 F. Supp. 1066 (M.D. Pa. 1972),
*aff'd without opinion*, 491 F. 2d 752
(3rd Cir. 1973) ..... 9


## LEGAL WRITINGS


Johnson, *The Commodity Futures Trading*
*Commission Act: Preemption as Public Policy*,
29 Van. L. Rev. 1 (Jan. 1976) ..... 12

Long, *The Naked Commodity Option Contract*
*As A Security*, 15 Wm. & Mary L. Rev. (1974) ..... 10

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SECURITIES COMMISSIONER
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vs.

INTERNATIONAL TRADING, LTD.,
A DIVISION OF GNB, INC.,
J. R. ROSE AND ARTHUR PALMER ..... *Respondents*

---

## PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF ARKANSAS

The Petitioner, Harvey L. Bell, Arkansas Securities Commissioner, respectfully prays that a Writ of Certiorari be issued to review the judgment and opinion of the Supreme Court of the State of Arkansas entered in this proceeding on October 3, 1977.

## OPINION BELOW

The opinion of the Supreme Court of the State of Arkansas is found in Volume 262 of the Arkansas Reports at page 244 and is also found in Volume 556 Southwestern Reporter, 2d edition at page 420. A copy of that opinion, along with a copy of that court's decree, appears in Appendix A hereto. No opinion was rendered by the Chancery Court of Pulaski County, Arkansas, the Court of original jurisdiction but the Order entered by that Court is attached as Appendix B hereto.

## JURISDICTION

The Judgment of the Supreme Court of the State of Arkansas was entered on October 3, 1977. A timely petition for rehearing *in banc* was denied on November 7, 1977, Appendix C hereto, and this Petition for Certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1257 (3).

## QUESTION PRESENTED

Whether the Commodity Futures Trading Commission Act of 1974 (CFTCA) preempted the State of Arkansas from enforcing the anti-fraud portion of its Securities Act against the seller of a London commodity option.

## STATUTORY PROVISIONS INVOLVED

United States Code Title 7:

*§ 2 Regulation of Trading and Exchange Activities.*



". . . provided, that the Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of or is commonly known in the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to Section 5 of this Act or any other board of trade, exchange or market, in transactions subject to regulation by the Commission pursuant to Section 217 of the Commodity Futures Trading Commission Act of 1974: And provided further, that, except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any state, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any state . . . ."

Ark. Stat. Ann. § 67-1247(1) (Repl. 1966). *Definitions of terms used.*

"Security" means any note; . . . evidence of indebtedness; certificate of interest or participation in any profit sharing agreement; . . . investment contract; . . . .

Ark. Stat. Ann. § 67-1235 (Repl. 1966). *Unlawful acts in connection with offer, sale or purchase of securities.*

It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly

(1) to employ any device, scheme or artifice to defraud

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, no misleading, or

(3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

Ark. Stat. Ann. § 67-1254 (Repl. 1966). *Enforcement of Act by Injunction or Mandamus.*

Whenever it appears to the Commissioner, upon sufficient grounds or evidence satisfactory to the Commissioner, that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this Act [The Arkansas Securities Act of 1959, as amended, Ark. Stat. Ann. § 67-1235 et seq. (Repl. 1966)] or any rule or order hereunder, he may summarily order the person to cease and desist from such act or practice, which order shall be effective for not more than 20 days during which time the Commissioner may apply to the Chancery Court of Pulaski County to enjoin the act or practice and to enforce compliance with this Act or any rule or order hereunder; however, the Commissioner may, without issuing a cease and desist order, apply directly to the Chancery Court of Pulaski County for the aforesaid relief. Upon a proper showing a permanent or temporary injunction,



restraining order, or writ of mandamus shall be granted and a receiver or conservator may be appointed for the defendant or the defendant's assets. The Court may not require the Commissioner to post bond.

## STATEMENT OF THE CASE

The original action in this case was filed on November 10, 1976 by the Petitioner, the Arkansas Securities Commissioner, seeking preliminary and permanent injunctions to restrain the Respondents from, among other things, violating Section 1 of the Arkansas Securities Act of 1959, as amended, the anti-fraud provision of the Arkansas Securities Act.

The Petition for Injunction filed by the Commissioner alleged that commencing in the spring of 1975, the Respondents sold London commodity options (options, traded on the London Commodity Options Exchange, to buy or sell commodity futures contracts) by various fraudulent means. The London commodity options were alleged to be investment contracts, evidences of indebtedness or participations in profit sharing agreements and hence securities as defined by Section 13(1) of the Arkansas Securities Act [Ark. Stat. Ann. § 67-1247 (Repl. 1966)]. An ex parte order was entered on November 16, 1976 setting a hearing for December 14, 1976 to consider the Petitioner's request for a preliminary injunction.

On December 6, 1976, the Respondents filed a Demurrer to the Petition for Injunction, based on two grounds. The first was that it appeared on the face of the Petition that the Chancery Court of Pulaski County, Arkansas had no jurisdiction of the subject matter of the action. This assertion was predicated on the Commodity Futures Trading Commission

Act of 1974 which established a new Federal regulatory agency, the Commodity Futures Trading Commission and conferred exclusive jurisdiction on the CFTC vis-a-vis the states and the Securities and Exchange Commission with respect to regulation of commodity options and commodity trading advisors. The second ground of the Demurrer was that the Petitioner lacked the legal capacity to bring the action.

Petitioner filed a Motion to Overrule the Demurrer on December 9, 1976. A hearing was held on December 14, 1976 at which the Petitioner presented testimony of three witnesses who had purchased commodity options from the Respondents. The Respondents maintained that their Demurrer should be sustained on the pleadings and presented no testimony in their behalf.

The first witness called by the Petitioner indicated that he had purchased a cocoa option from the Respondents for $3,000.00. The witness testified that it had been requested of him to sign a Power of Attorney so that the Respondents could trade his account in his name, but the witness refused. The witness testified that at some later date he contacted the Respondents seeking information concerning the cocoa market and how well his cocoa option was doing. He was informed that his cocoa option had been sold by the Respondents and that a sugar option had been purchased with the profit. The witness stated that he accepted a check in the amount of $574.00 representing the difference in the sale price of his cocoa option and the purchase price of the new sugar option but that he refused to invest further with the Respondents. Some months later the sugar option was abandoned by the Respondents and the witness lost all but $574.00 of his investment.



The second witness called by the Petitioner testified substantially as the first witness except that after initially refusing to sign the Power of Attorney this witness relented. He too lost all but $574.00 of his investment.

The third witness called by the Petitioner testified that he purchased an option from the Respondents based upon their "guarantee" that he would double his money. The option so purchased was later abandoned by the Respondents with this witness losing his entire investment.

At the conclusion of the evidence presented to the Chancellor, the Chancellor overruled the Demurrer and enjoined the Respondents from selling London commodity options by fraudulent or misleading means. The Chancellor did not, however, make a specific finding from the bench that the Respondents had engaged in fraudulent conduct.

The Respondents appealed to the Arkansas Supreme Court which reversed and dismissed the Petitioner's Complaint holding that the Petitioner had no standing to file suit and that the Chancery Court of Pulaski County, Arkansas, had no jurisdiction to entertain such suit because of the preemption of the entire commodities field by the enactment of the Commodity Futures Trading Commission Act of 1974.

## REASON FOR GRANTING WRIT

THE ENACTMENT OF THE COMMODITY FUTURES TRADING COMMISSION ACT OF 1974 HAS CREATED CONTROVERSY CONCERNING THE EXTENT TO WHICH STATES CAN ACT IN LIGHT OF THE "EXCLUSIVE JURISDICTION" OVER

## COMMODITIES TRANSACTIONS GRANTED TO THE COMMODITY FUTURES TRADING COMMISSION.

Prior to the effective date of the CFTCA, state securities regulators, the Securities and Exchange Commission and private litigants all sought to effect a measure of protection and/or recovery for investors defrauded through the offer, sale or purchase of commodities, commodity futures contracts or commodity options by asking courts to fashion remedies based on applicable securities acts. Such requests met with varying success.

The federal courts which entertained such suits based their decisions on an analysis of *Securities and Exchange Commission* v. *W. J. Howey & Company, et al.*, 328 U.S. 293 (1946). While the offer and sale of a commodities contract for future delivery standing alone was generally held not to involve the offer and sale of a "security", *Sinva, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 253 F. Supp. 359 (S.D.N.Y. 1966), when that offer and sale was coupled with or made part of a managed or discretionary account, a claim cognizable under the securities acts was recognized by courts sitting in the Second Circuit, *Johnson* v. *Espey, et al.*, 341 F. Supp. 764 (S.D.N.Y. 1972), *Berman* v. *Orimex Trading, Inc.*, 291 F. Supp. 701 (S.D.N.Y. 1968), *Mahue* v. *Reynolds & Company*, 282 F. Supp. 423 (S.D.N.Y. 1967); courts sitting in the Fifth Circuit, *Securities and Exchange Commission* v. *Continental Commodities Corp.*, 497 F. 2d 516 (5th Cir. 1974), *McCurrin* v. *Kohlweger & Company, et al.*, 340 F. Supp. 1338 (E.D. La. 1972) aff. 477 F. 2d 113 (5th Cir. 1973), *Gould* v. *Barnes Brokerage Company, Inc.*, 345 F. Supp. 294 (N.D. Tex. 1972); courts sitting in the Eighth Circuit, *J. C. Booth* v. *Peavey Company Commodities Services*, 430 F. 2d 132 (8th Cir. 1970), *Marshall* v. *Lamson Brothers & Co., et al.*, 368 F. Supp. 486 (S.D. Ia. 1974),



*Schwartz* v. *Bache & Company, Inc.*, 340 F. Supp. 995 (S.D. Ia. 1972); and the Tenth Circuit Court of Appeals, *Commercial Iron & Metal Company* v. *Bache & Company et al.*, 478 F. 2d 39 (10th Cir. 1973). Such claims were however rejected by courts sitting in the Seventh Circuit, *Milnarik* v. *M.S. Commodities, Inc.*, 320 F. Supp. 1149 (N.D. Ill. 1970), *aff'd*, 457 F. 2d 274 (7th Cir. 1972) and *Hirk* v. *Agri-Research Council, Inc., et al.*, CCH, Sec. L Rep. par. 94, 738 (N.D. Ill. 1974) and further rejected by the District Court for the middle district of Pennsylvania, *Wasnowic* v. *Chicago Board of Trade*, 352 F. Supp. 1066 (M.D. Pa. 1972), *aff'd without opinion*, 491 F. 2d 752 (3rd Cir. 1973). The difference in opinion turned on the respective courts' interpretation of the common enterprise requirement necessary for a finding of an investment contract as defined in *Howey*, supra. The Seventh Circuit stated that there had to be a "pooling" of investor funds while the remaining Courts considering the problem stated that there need be only a common enterprise between the investor and promoter and not among investors similarly situated.

The Petitioner in the suit below alleged fraudulent discretionary transactions in respondents' customers' commodity options accounts and in addition alleged certain material misrepresentations and omissions in connection with the initial offer and sale of the commodity options themselves. A commodity option is a contract right, purchased from the option seller for a fee called the "premium," to buy from, or sell to, the option seller, the underlying commodity futures contract at a fixed price called the "striking price," at any time during the life of the option. The striking price is usually the market price of the underlying commodity futures contract on the day that the option contract is sold. The option period is usually fixed, ranging from one month to a year or 18 months. An option to sell the underlying commodity futures contract is known as a "put." An

option to buy the underlying commodity futures contract is known as a "call." It is also possible for the option purchaser to buy both a put and a call on the same commodity at the same time. Such a purchase is known as a "straddle," or, more commonly, as a "double option." Long, *The Naked Commodity Option Contract As A Security,* 15 Wm. & Mary L. Rev. 211, 212-14 (1974).

The purchaser of a call theoretically makes his profit when the market for the underlying commodity futures rises. If this occurs, he exercises his option, purchasing the underlying commodity futures contract from the option seller at the striking price and reselling it in the open market. His profit is the difference between the striking price and his selling price, less the premium he paid for the option. The purchaser of a put will profit similarly if the market falls sufficiently from the striking price for his profit on the futures contract to exceed the premium. *Id.* at 213. The purchaser of a double option will profit whether the market rises or falls, provided that the difference between the rise or fall and the striking price exceeds the premium he paid to the option seller.

Commodity option contracts in various forms have been present for a number of years. Before 1934, contracts on domestic commodities, such as wheat and cotton, were traded extensively on the major American exchanges. In that year, however, the Commodity Exchange Authority (CEA) banned trading in options on domestic commodities because of the abuses which had developed in the commodity option market. Trading in international, or "world" commodities, including silver, silver coins, platinum, cocoa, plywood, copper, coffee, and world sugar, was not affected, since such items were not subject to CEA jurisdiction. Long, *op. cit. supra,* pp. 213-14.



A distinction must be noted between "naked" commodity options which have no underlying futures contract and the London commodity options which were sold by respondents. The naked commodity option is an option issued by the seller for which there is no underlying futures contract. By the great weight of judicial authority, such options are securities. See: Long, *op. cit. supra,* p. 217.

In contrast to the naked option, the "London option" is an option on an underlying futures contract traded on the London commodity exchanges. The options are issued, or "written," by the same exchanges. "World" commodities such as sugar, cocoa, coffee, rubber, silver and copper are traded on the London exchanges. Such options too have been held to be securities. *Clayton Brokerage Co.* v. *Mouer,* 520 S.W. 2d 802, 804 (Tex. Civ. App. 1975), *rev'd on other grounds,* 531 S.W. 2d 805 (Tex. Sup. Ct. 1975).

While the issue of whether such London commodity options were securities within the meaning of the Arkansas Securities Act was pivotal in determining Petitioner's initial standing to bring suit, that question was left undecided by the Arkansas Supreme Court, *International Trading, Ltd. et al.* v. *Bell,* 556 S.W. 2d 420, 422 (1977) (Appendix "A" at page 22), and is therefore not pertinent here. For purposes of this Petition, Petitioner, like the Arkansas Supreme Court, assumes that such options are investment contracts. The question then presented concerns the Arkansas Court's analysis of 7 U.S.C.A. § 2 (Supp. 1977) which according to that Court . . . "seems . . . to express a clear intention to vest exclusive jurisdiction of the regulation of commodity options in the Commodity Futures Trading Commission and to supersede the jurisdiction of all state and federal agencies." *International Trading, Ltd.* v. *Bell, supra,* at 556 S.W. 2d page 423 (Appendix "A" at page 26).

Petitioner does not here challenge the ability of Congress to preempt the field of commodities regulation under the Commerce clause of the United States Constitution. See, e.g., *Hamilton* v. *Kentucky Distilleries and Warehouse Company*, 251 U.S. 145 (1919). Petitioner does however question the construction placed on that preemption by the Supreme Court of Arkansas and the CFTC.

The Court's attention is directed to the Report of the Senate Agriculture and Forestry Committee on H.J.R. Res. 335:

> The Committee wishes to make clear that the preemption of the regulation of commodity futures trading by the Commodity Futures Commission Act of 1974 does not prevent the States from enforcing their criminal anti-fraud statutes. The Committee realizes that many fraudulent schemes are devised to prey on the unsuspecting and unsophisticated investor. In many cases, these schemes purport to deal in commodities trading. The States are encouraged to continue to utilize their criminal anti-fraud statutes to discourage such schemes. (S. Rep. No. 74-73, 94th Cong., 1st Sess. [1975]).

The above section of the Senate report has been interpreted to permit State Courts to continue to adjudicate state criminal fraud cases. Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 Van. L. Rev. 1, 33 (Jan. 1976). Such interpretation is consistent with the position of the CFTC expressed on page 19 of their brief, amicus curiae, filed with the Arkansas Supreme Court in the instant case and is further consistent with the position of the Arkansas Court as expressed on 556 S.W. 2d page 425 (Appendix "A" at page 29). Petitioner has been unable to find justification for the distinction drawn by



the CFTC which would allow enforcement of some state anti-fraud statutes yet preempt others. If in fact "all state and federal agencies" have been preempted, logic would seem to indicate that no state statute nor any federal statute, save the CFTCA, could be enforced against persons effecting fraudulent transactions in commodities. A ludicrous extension of that position would be to preempt any local law enforcement agency from taking action against thieves who were stealing raw commodities.

It is apparent from reading law review articles and CFTC memorandums that it is state securities regulators and the SEC that the commodities industry and the CFTC wish preempted. All other federal, state and local agencies are allowed by the CFTC to enforce their statutes.

It is the position of the Petitioner that if general anti-fraud statutes can be enforced against fraudulent commodities brokers then specific anti-fraud statutes prohibiting fraud in connection with the offer and sale of investment contracts should also be enforced.

Congress in enacting the CFTCA did not enact legislation preempting selected agencies. If Congress declares that a particular agency has exclusive jurisdiction, then there is no room for other agencies to regulate in that field. As stated by the Eighth Circuit Court of Appeals in *Northern States Power Company* v. *Minnesota*, 447 F. 2d 1143 (8th Cir. 1971):

> "Where Congress has unequivocally and expressly declared that the authority conferred by it is exclusive, then there is no doubt but that states cannot exert concomitant or supplementary regulatory authority over the identical activity." *Northern States*, supra, at 1146.

The question then presented is whether the Arkansas Securities Commissioner by filing suit to enjoin fraudulent sales of investment contracts in the form of London Commodity Options is "regulating" the offer and sale of those options within the meaning of *Northern States Power Company*, supra., or whether he is simply enforcing an anti-fraud statute compatible with the Senate report cited above.

The Arkansas Securities Commissioner is not seeking to license persons or otherwise regulate London Commodity Options but rather he, as the representative of the State of Arkansas, is seeking to prohibit through injunction certain fraudulent conduct.

Petitioner submits it was not the intent of Congress to preempt the State of Arkansas from enforcing Arkansas' securities fraud laws by passage of the CFTCA. The State of Arkansas seeks to enforce a securities fraud law — not to regulate commodities. Congress never intended to deny the State of Arkansas and its courts the right to protect Arkansas citizens from perpetrators of fraud and deceit. Such malefactors should and must be enjoined from engaging in fraudulent businesses entirely.

The Court's attention is directed to Section 21 of the Arkansas Securities Act [Ark. Stat. Ann. § 671255 (Supp. 1977)] which provides criminal sanctions for persons who willfully violate that Act.

It is inconsistent to hold that the State of Arkansas, pursuant to Ark. Stat. Ann. § 41-2203 (Crim. Code 1976), a general "theft by deception" statute, can prosecute persons engaging in fraudulent commodities operations, *International Trading, Ltd.* v.



*Bell*, supra at 556 S.W. 2d page 425 (Appendix "A" at page 29), but cannot so prosecute under Ark. Stat. Ann. § 67-1235 (Repl. 1966), the Securities Act "anti-fraud" section, due to the "clear intention [of Congress] to vest exclusive jurisdiction of commodity options in the Commodity Futures Trading Commission and to supersede the jurisdiction of all state and federal agencies." *International Trading, Ltd.* v. *Bell*, supra, at 556 S.W. 2d page 423 (Appendix "A" at page 26). Either the State of Arkansas has been preempted or it has not.

Petitioner believes the more reasoned approach to this inconsistency is to recognize the grant of exclusive jurisdiction to "regulate" commodities in the CFTC but to allow the enforcement of anti-fraud statutes by the states whether those statutes are grounded in the general common law or contained in other specialized statutes such as the Securities Acts. Certainly, if state anti-fraud enforcement and federal regulation become inconsistent, federal preemption would apply. The Petitioner is not seeking to interfere with the federal regulatory scheme over the commodities industry but only is seeking to protect the Arkansas investors from fraud. Surely Congress could not have meant to deny him that ability.

## CONCLUSION

For the reasons hereinabove stated, Petitioner respectfully submits that his Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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## APPENDIX "A"

### REVERSALS CHANCERY DISTRICTS

STATE OF ARKANSAS,
SCT.
In the Supreme Court

BE IT REMEMBERED, That a term of the Supreme Court of the State of Arkansas, begun and held at the Court House, in the City of Little Rock, on the 3rd day, being the first Monday of October, A.D. 1977, amongst others, were the following proceedings, to-wit: On the 3rd day of October, A.D. 1977, a day of said term:

International Trading Ltd.,
a division of GNB, Inc. et al
Appellant

No. 77-96 vs.

Harvey L. Bell, Securities Commissioner
Appellee

Appeal from Pulaski Chancery Court
Second District

THIS CAUSE came on to be heard upon the transcript of the record of the Chancery Court of Pulaski County, Second District, and was argued by solicitors; on consideration whereof it is the opinion of the Court that there is error in the proceedings and decree of said Chancery Court in this cause as set out in the opinion herein delivered October 3, 1977.

IT IS THEREFORE ORDERED AND DECREED by the Court that the decree of said Chancery Court in this cause rendered be, and the same is hereby reversed, annulled and set aside with costs; and that this cause be dismissed.

IT IS FURTHER ORDERED AND DECREED, That said appellants recover of said appellee all their costs in this Court in this cause expended, and have execution thereof.

IN TESTIMONY, That the above is a true copy of the decree of said Supreme Court rendered in the case therein stated, I, Jimmy H. Hawkins, Clerk of said Supreme Court, hereunto set my hand and affix the Seal of said Supreme Court, at my office in the City of Little Rock, this 7th day of November, A.D. 1977.

JIMMY H. HAWKINS
Clerk
By Dona L. Williams
D.C.



SUPREME COURT OF ARKANSAS

INTERNATIONAL TRADING LTD.,
A Division of GNB, Inc.:
GNB, Inc., J. R. ROSE and Arthur PALMER
*v.* Harvey L. BELL, Securities
Commissioner for the State of
Arkansas

77-96

Opinion delivered October 3, 1977
(In Banc)

Appeal from Pulaski Chancery Court, Second Division, *John T. Jernigan*, Chancellor; reversed and dismissed.

JOHN A. FOGLEMAN, Justice. The chancery court enjoined appellants from directly or indirectly employing any device, scheme or artifice to defraud; making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, or, engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. In doing so, the court overruled appellants' demurrer. Appellants elected to stand on that demurrer, which alleged that it appeared on the face of the complaint that the court had no jurisdiction of the subject matter and that appellee did not have the legal capacity to sue in this ac-

tion. Since we find that the chancery court erred in overruling this demurrer, we must reverse the decree.

The complaint was filed by the Securities Commissioner for the State of Arkansas under the Arkansas Securities Act, as amended [Ark. Stat. Ann. § 67-1235 et seq]. In it, he alleged that International Trading, Ltd., a division of GNB, Inc., GNB, Inc., J. R. Rose and Arthur Palmer were engaging in acts and practices and a course of conduct which constitute violations of various sections of the act in offering and selling a type of commodity option contracts known as "London commodity options." He alleged that these acts and practices constituted a device, scheme or artifice to defraud and would operate as a fraud or deceit upon the purchasers of options and that appellants made misrepresentations of material facts or omitted to state material facts necessary to make the statements made not misleading in the light of the circumstances under which they were made. The acts and conduct specified were:

(a) engaging in an organized statewide, high-pressure, "boiler room" like sales campaign, conducted primarily by repeated, unsolicited, "cold-canvass" long distance telephone calls to persons who were inexperienced and unsophisticated as to London commodity options transactions, in which calls false and deceptive statements were made about profit expectations and the advisability of immediate purchase of such options to take advantage of purported favorable market prices for the options;

(b) hiring and directing sales persons without experience or knowledge of the risks and trading mechanics involved in such options and providing these salesmen with glowing, but deceptive and misleading "canned" sales speeches to be read to potential customers over the telephone, instructing these salespersons to conceal material facts, avoid unfavorable ex-



planations, provide only minimal information, and tell these prospects anything to make a sale;

(c) representing and making it appear that the options being offered and sold would be purchased in the London market in the names of such customers, with the company acting as the purchaser's agent, when in fact the options were purchased in the name of the company for its own account at prices substantially less than the customers paid the company;

(d) representing, without any reasonable basis, profits or returns which would double or triple the purchase price in a short period of time, but failing to disclose that many customers had actually lost their investments;

(e) concealing and misrepresenting the true nature of the purchase price, including all fees and markups, which customers pay to the company for the purchase of London commodity options; concealing the fact that the company marks up the price of each option purchased in the London markets between 40 and 150 percent;

(f) representing to purchasers and prospective purchasers that the company's salespersons are well trained and have several years' experience in the commodity option field, when, in fact, most of them have had substantially less than one year's experience and the company provides no meaningful training to such salespersons, who are not specialists in the field of commodity options;

(g) failing to state that International Trading, Ltd., a division of GNB, Inc., and GNB, Inc. are foreign corporations not authorized to do business in Arkansas;

(h) failing to disclose the risk of loss to potential investors;

(i) failing to disclose that the investors were purchasing a commodity option rather than a true contract for future delivery of commodities;

(j) failing to disclose the actual closing date for transactions traded on the London Board of Options Exchange;

(k) using high pressure telephonic sales techniques emphasizing the likelihood of profits and not considering the investment needs of the customer;

(l) excessively marking up the price of the London commodity options sold to Arkansas investors;

(ll) receiving compensation directly and indirectly for advising potential investors as to the value of these securities and employing a device, scheme or artifice to defraud and engaging in acts, practices or course of business which operated or would operate as a fraud or deceit upon purchasers in violation of Ark. Stat. Ann. § 67-1236 (a) (Repl. 1966) by omitting to state the material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

The court heard appellee's evidence on the allegations of fraud, but appellants, having elected to stand upon their demurrer, offered no evidence. Even so, the chancellor declined to make a finding that appellants had been guilty of fraud. The language of the decree stating the acts enjoined is couched entirely in words of § 1 of the Arkansas Securities Act [Ark. Stat. Ann. § 67-1235 (Repl. 1966)] declaring those acts, in connection with the offer, sale or purchase of securities to be unlawful.

For the purposes of this opinion we assume, but do not decide, that a London commodity option is a security, as



alleged in appellee's complaint and defined by Ark. Stat. Ann. § 67-1247 (1). If it is, it would be subject to regulation under the Arkansas Securities Act, except for the preemption of the field by the United States Congress through the Commodity Futures Trading Commission Act, an amendment to the Commodity Exchange Act. 7 USCA § 1 et seq.

In order to understand the question presented, it is necessary that certain terms, not generally familiar, be defined, as we understand them.

A commodity futures contract is a contract by which a seller agrees to deliver a definite quantity of a commodity in a specified future month, and the purchaser agrees to accept and pay for the commodity when it is delivered. The terms of the contract, except for the price, are fixed by the organized exchange through which the trading is done. Campbell, Trading in Futures Under the Commodity Exchange Act, 26 George Washington Law Review 215, 216-218. The price is determined by open bidding by traders on the floor of the commodity exchange. See *Clayton Brokerage Co. of St. Louis* v. *Mouer*, 520 S.W. 2d 802 (Tex. Civ. App., 1975); § 7 USCA §§ 6, 6b, 6c, Supp. 1977.

A commodity option is a contract right, purchased from the option seller for a fee called the "premium," to buy from, or sell to, the option seller, the underlying commodity futures contract at a fixed price called the "striking price," at any time during the life of the option. The striking price is usually the market price of the underlying commodity futures contract on the day that the option contract is sold. The option period is usually fixed, ranging from one month to a year or 18 months. An option to sell the underlying commodity futures contract is known as a "put." An option to buy the underlying commodity futures contract is known as a "call." It is also possible for the option purchaser to buy both a put and a call on the same commodity at the same time. Such a purchase is known as a "straddle," or, more commonly, as a

"double option." Long, The Naked Commodity Option Contract as a Security, 15 Wm. & Mary L. Rev. 211, 212-14 (1974).

The purchaser of a call theoretically makes his profit when the market for the underlying commodity futures rises. If this occurs, he exercises his option, purchasing the underlying commodity futures contract from the option seller at the striking price and reselling it in the open market. His profit is the difference between the striking price and his selling price, less the premium he paid for the option. The purchaser of a put will profit similarly if the market falls sufficiently from the striking price for his profit on the futures contract to exceed the premium. Id. at 213. The purchaser of a double option will profit whether the market rises or falls, provided that the difference between the rise or fall and the striking price exceeds the premium he paid to the option seller. A commodity option is considered a more conservative investment than a commodity futures contract because the risk of loss is limited to the premium paid and is not a concomitant of price fluctuations in the commodity which may lead to additional margin calls. Note, Federal Legislation for Commodity Option Trading: A Proposal, 47 So. Cal. L. Rev. 1418, 1424-25 (1974).

Commodity option contracts in various forms have been present in the financial market place for a number of years. Before 1934, contracts on domestic commodities, such as wheat and cotton, were traded extensively on the major American exchanges. In that year, however, the Commodity Exchange Authority (CEA) banned trading in options on domestic commodities because of the abuses which had developed in the commodity option market. Trading in international, or "world" commodities, including silver, silver coins, platinum, cocoa, plywood, copper, coffee, and world sugar, was not affected, since such items were not subject to CEA jurisdiction. Long, cit. supra, pp. 213-14.



A London option is a right, for a price, to purchase or sell a commodity futures contract for a specified term at a specified price. Thus it is simply an extention of a commodity futures contract and is traded on the same London commodity exchanges as the underlying futures contract. World commodities traded on the London exchange include sugar, cocoa, coffee, rubber, silver and copper. See *Clayton Brokerage Co. of St. Louis, Inc.* v. *Mouer*, supra, appeal dismissed as mooted by reason of preemption by Commodity Futures Trading Commission Act of 1974, 531 S.W. 2d 805. For other discussions defining these terms and the commodity trading business, see *British American Commodity Operations Corp.* v. *Bagley*, 552 F. 2d 482 (2 Cir., 1977). For a discussion of the London option market and the sale of London options in the United States, see Long, Commodity Options — Revisited, 25 Drake L. Rev. 75, 111-128 (1975).

The language which we find to be a clear manifestation of the intention of Congress to exclude states from this field is found in provisos added to the Commodity Exchange Act by the Commodity Future Trading Act as set out in 7 USCA § 2 (Supp. 1977). They are:

> *** *Provided*, That the Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 7 of this title or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 15a of this title: *And provided further*, That, except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the

United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State. ***

The language seems to us to express a clear intention to vest exclusive jurisdiction of the regulation of commodity options in the Commodity Futures Trading Commission and to supersede the jurisdiction of all state and federal agencies. Our conclusion is fortified by another section of the act, now appearing as 7 USCA 6c (b) (Supp. 1977), where Congress said:

No person shall offer to enter into, enter into, or confirm the execution of, any transaction subject to the provisions of subsection (a) of this section involving any commodity regulated under this chapter, but not specifically set forth in section 2 of this title, prior to the enactment of the Commodity Futures Trading Commission Act of 1974, which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe within one year after the effective date of the Commodity Futures Trading Commission Act of 1974 unless the Commission determines and notifies the Senate Committee on Agriculture and Forestry and the House Committee on Agriculture that it is unable to prescribe such terms and conditions within such period of time: *Provided*, That any such order, rule, or regulation may be made only after notice and opportunity for hearing: *And provided further*, That the Commission may set different terms and conditions for different markets.



This view is further strengthened by the report of the Congressional Conference Committee on the House and Senate versions of the bill for the act in question. That committee said:

The clarifying amendments make clear that (a) the Commission's jurisdiction over futures contract markets or other exchanges *is exclusive and includes the regulation of . . . commodity options;* [and] (b) *the Commission's jurisdiction, where applicable, supersedes State as well as Federal agencies . .*

Under the exclusive grant of jurisdiction to the Commission, the authority in the Commodity Exchange Act (and the regulations issued by the Commission) would preempt the field insofar as futures regulation is concerned . . . . *In view of the broad grant of authority to the Commission to regulate the futures trading industry, the Conferees do not contemplate that there will be a need for any supplementary regulation by the States.* [Emphasis ours.]

See Senate Miscellaneous Reports on Public Bills, IX, Sen. Rep. 1178-1239, 93d Congress, 2d Session, pp. 35-36; see also, *Securities and Exchange Commission* v. *American Commodity Exchange, Inc.*, 546 F. 2d 1361 (10 Cir., 1976) for other legislative history.

The vesting of exclusive jurisdiction is a clear indication that Congress intended no regulation in this field except under the authority of the act. See *Rice* v. *Santa Fe Elevator Co.*, 331 U.S. 218, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947); Johnson, Commodity Futures Trading Act: Preemption as Public Policy, 29 Vanderbilt L. Rev. 1, 2, 20.

Where the act conferred jurisdiction on the commission, at least one other court has held that it preempted the field of regulation insofar as the states are concerned. *State* v. *Monex International, Limited*, 527 S.W. 2d 804 (Tex. Civ. App., 1975).

applied to London commodity options in *Clayton Brokerage Co. of St. Louis* v. *Moeur*, 531 S.W. 2d 805 (Tex. Sup. Ct., 1975). It has also been held that the act stripped the Securities Exchange Commission of authority previously vested in it. *Securities Exchange Commission* v. *Univest, Inc.*, 405 FS 1057 (DC, Ill., 1975), 410 FS 1029, remanded 556 F. 2d 584 (7 Cir., 1977). There is at least tacit recognition of the preemption in some cases in which it has beeh held that pending actions or actions taken before the newly created commission could act were not affected. See, e.g., *State* v. *Spannus Coin Wholesalers, Inc.*, 250 N. W. 2d 587 (1976).

Appellee makes some very appealing arguments in seeking to sustain his position that there is no preemption. First, he seizes upon the clause stating that "except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on . . . other regulatory authorities under the laws . . . of any State or (ii) restrict . . . such other authorities from carrying out their duties and responsibilities in accordance with such laws," and the statement that "[n]othing in this act shall be deemed to supersede or limit the jurisdiction conferred on courts of . . . any state." The argument that the exception relates only to regulation of commodities, not securities, is unavailing here because of the clear language of the act bringing commodity options within the purview of the act. The exception, then, eliminates the subject matter of this action from the jurisdiction of the regulatory laws of a state. Perhaps the Commodity Futures Trading Commission cannot regulate London exchanges, but it does have jurisdiction over accounts, agreements (including options) and transactions on contract markets or any other board of trade, exchange or market.

Appellee also argues that because the Arkansas Securities Act is not in conflict with the federal act, he should not be prevented from enforcing the state regulatory scheme. Where, however, as here, Congress has made it clear that authority conferred by it is exclusive in a given area the states



cannot exercise concomitant or supplementary regulatory authority over the identical activity. *Northern States Power Co.* v. *State*, 447 F. 2d 1143 (8 Cir., 1971); *Rice* v. *Santa Fe Elevator Corp.*, supra, 331 U.S. 218; *Campbell* v. *Hussey*, 368 U.S. 297, 82 S. Ct. 327, 7 L. Ed. 2d 299 (1961).

Appellee, consistent with his argument that Congressional intent to preempt is not manifest, invokes a test he finds in *Northern States Power Co.* v. *State*, supra, i.e.: (1) what is the intent of Congress as expressed in the legislative history of the act (2) how pervasive is the federal regulatory scheme (3) does the nature of the subject require exclusive regulation and (4) is state law an obstacle to federal enforcement. An affirmative answer to all these questions is not required as a basis for finding an implied federal preemption. The court in that case stated these tests only as factors to be considered. Although we would be compelled to answer the fourth question in the negative, if we consider only the terms of the Arkansas Securities Act as presently written, the potential for obstacles is just as important as their existence. See *Rice* v. *Santa Fe Elevator Corp.*, supra. Commodity Futures Trading Commission regulations could change this answer. As to the other questions, our answers are in the affirmative. We have already mentioned the legislative history and the broad scope of the Commodity Futures Trading Commission Act. There was at least a Congressional finding that the nature of the subject matter demanded exclusive federal regulations and we cannot say that this finding was unfounded. See Johnson, The Commodity Futures Trading Commission Act: Preemption as a Public Policy, 29 Vanderbilt Law Review 1. Even if we apply appellee's tests, we find a strong implication that federal preemption was intended.

We do not agree with appellee that preemption will prevent the state from protecting its citizens from fraud. There is no reason why the state cannot prosecute an offender under such provisions as § 41-2203 (Crim. Code, 1976). There is no bar of actions by persons defrauded to recover money ob-

tained from them by fraud. Such actions could not constitute any realistic threat of interference withthe federal regulatory scheme and the act certainly does not afford protection of fraudulent conduct. See *Farmer* v. *United Brotherhood of Carpenters of America*, 430 U.S. 290, 97 S. Ct. 1056, 51 L. Ed. 2d 338 (1977).

Finally, appellee's invocation of the Tenth Amendment is unavailing where the Congress had the power to act and, in acting, manifestly intends to preempt the field. In such a case, the supremacy clause (Art. VI, § 2) clearly has a bearing. See *Rice* v. *Santa Fe Elevator Corp.*, supra, 331 U.S. 218; *Northern States Power Co.* v. *State*, supra, 447 F. 2d 1143. We do not understand appellee to argue that Congress has no power to regulate trading in London commodity options in the United States. It seems rather obvious to us that Congress does have the power under the commerce clause of the United States Constitution. This case does not involve the exercise of power which impairs the integrity of the states on their ability to function effectively, as was the case in *National League of Cities* v. *Usery*, 426 U.S. 833, 96 S. Ct. 2465, 49 L. Ed. 2d 245 (1976) upon which appellant relies. The case involved an attempt by Congress to prescribe minimum wages to be paid to state employees by the states, acting in their sovereign capacity. Clearly, there is no such invasion of the sovereignty of the states involved here. Here the exercise of congressional authority was directed to private citizens, not to the states as states, or to functions essential to their separate and independent existence.

We find that the chancery court had no jurisdiction to act in this proceeding under the provisions of the Arkansas Securities Act, and that the appellee had no standing to bring this action so the decree of the chancery court is reversed and the cause is dismissed.

HICKMAN, J., dissents.



## APPENDIX "B"

### IN THE CHANCERY COURT OF PULASKI COUNTY, ARKANSAS

HARVEY L. BELL, SECURITIES COMMISSIONER FOR THE STATE OF ARKANSAS — PETITIONER

VS. — No. 76-5009

INTERNATIONAL TRADING, LTD., A DIVISION OF GNB, INC.: GNB, INC.: J. R. ROSE AND ARTHUR PALMER — RESPONDENTS

### ORDER

On this day comes to be heard the Demurrer filed in behalf of Respondents and the Petition for Injunction filed by Petitioner and Respondents appearing through their Attorney, Joel Bellows, and Petitioner appearing through his Attorneys, Ted Goodloe and James T. Pitts, and this cause being submitted to the Court for final adjudication by consent of the parties, and from the facts and matters presented and tried on the merits, the Court being well and sufficiently advised finds:

(1) That the Demurrer filed in behalf of Respondents herein should be overruled. That this Court has jurisdiction over the persons and the subject matter of this action and that the Petitioner has standing to bring this suit.

(2) That London Commodity Options offered and sold by Respondents in this State are investment contracts and are

hence securities as defined by Section 13(1) of the Arkansas Securities Act [Ark. Stat. Ann. § 67-1247(1) (Repl. 1966).]

(3) That Respondents, in connection with the offer and sale in this State of investment contracts styled London Commodity Options should be enjoined from directly or indirectly employing any device, scheme or artifice to defraud; making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading; or, engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

IT IS THEREFORE ORDERED that Respondents' Demurrer be and the same is hereby ordered overruled and that the Respondents in connection with the offer and sale in this State of investment contracts styled London Commodity Options be and the same are hereby ordered enjoined from directly or indirectly employing any device, scheme or artifice to defraud; making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading; or, engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

/s/ John T. Jernigan
CHANCELLOR

DATE: Dec. 15, 1976

APPROVED AS TO FORM:



/s/ Joel Bellows
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/s/ Ted Goodloe
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/s/ James T. Pitts
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Attorneys for Petitioner

## APPENDIX "C"

STATE OF ARKANSAS, }
SCT. }
In the Supreme Court

BE IT REMEMBERED, That at a term of the Supreme Court of the State of Arkansas, begun and held at the Court Room in the City of Little Rock, on the 3rd day, being the first Monday of October, A.D. 1977, amongst others were the following proceedings, to-wit:

On the 7th day of November, A.D. 1977, a day of said term

International Trading Ltd.,
a division of GNB, Inc. et al — Appellant

No. 77-96 — vs.

Harvey L. Bell, Securities Commissioner — Appellee

Appeal from Pulaski Chancery Court
Second Division

Petition for rehearing is denied.

IN TESTIMONY, That the above is a true copy of the Per Curiam of said Supreme Court, rendered in the case therein stated, I, JIMMY H. HAWKINS, Clerk of said Supreme Court, hereunto set my hand and affix the Seal of said Supreme Court, at my office in the City of Little Rock, this 7th day of November, A.D. 1977.

JIMMY H. HAWKINS
Clerk
By Melissa Milhollen
D.C.